Town of Orleans Finance Committee

Fiscal Year 2017 Annual Report and Letter to the Town

Introduction

The Town of Orleans Finance Committee ("the Committee") is charged by the Town Charter to provide an independent review of issues affecting the financial position of the Town and the taxpayers. This responsibility includes publishing an annual report and letter to the town and the taxpayers highlighting the work that the Committee has conducted during the current fiscal year. In recent years, the Committee has focused its efforts on the budgeting process, the capital budget, and new sources of revenue. During this fiscal year, the Committee has spent much of its effort on reviewing many of the financial risks that the Town faces, and some of the potential consequences of those risks. This letter is a review of those risks and the Committee's view on how the Town may address them, as well as the Committee's advice to the Town, the taxpayers, and the Orleans Board of Selectmen ("the Selectmen") regarding those risks.

The Town of Orleans historically has managed its budget with a view to maintaining a property tax rate believed to be "affordable" for the average Orleans taxpayer. This has principally been achieved through spending cuts and deferred spending exclusively. The proof-point is that Orleans enjoys one of the lowest tax rates per assessed value in the Commonwealth. While any budget management strategy carries its own set of risks, the Orleans Finance Committee believes that using near-term low taxes as a strategic budget management goal, and spending cuts and deferrals as the only tools to achieve this strategy, results in material financial risks to the Town and its taxpayers. Please note that this is not an exhaustive list of all risks the Town and its taxpayers face, but an overview of the risks that the Committee considers the most critical and the most likely to be realized under current policy.

Risks Related to the Operating Budget

The Selectmen have made it a matter of policy to shape each new fiscal year's operating budget with a view to limiting property tax increases to no more than 1.4%, below the limits imposed by Proposition 2½. It is the Selectmen's policy that the budget itself should generally increase no more than 2.5% per year. This budget policy is meant to be operative without regard to spending needs as they may be estimated by Town officials. Since the proposed zero-based budget approach recommended by the Committee and recognized as a priority by the Selectmen has not been adopted in a materially effective way, this compounds and perpetuates existing budgets without regard for the underlying assumptions that drive them.

The Town also lacks:

1. A consistent and overarching policy on fees for services and facilities.
2. Any meaningful analysis of the actual costs of delivering a number of services to allow it to determine the level of fees that would allow various departments to pay for themselves through the application of fees.

3. Efforts to maximize potential revenue streams from revenue-generating assets, and has foregone potentially significant operating revenue opportunities over a period of many years.

The Committee has identified one major risk related to this strategy of managing for the tax rate using spending cuts and deferred spending.

Risk of Service Denial: The Town offers a wide array of services to its taxpayers. Many of these services are of a critical nature for the well-being of its taxpayers; many others are critical for the upkeep of the Town itself. Managing the operating budget specifically oriented to the tax rate ignores the fact that cuts in the operating budget to meet that goal will sooner or later result in the denial of some of these services.

Risks Related to the Capital Improvement Plan

One way that the Selectmen have, over the past several decades, sought to manage the budget with a view to minimizing taxes is to defer capital spending. The Committee has identified a number of risks associated with the deferral of capital spending.

Risk of Increased Taxes: As noted in the Committee's letter to the Selectmen dated March 23rd, 2016, deferral of capital spending does not result in lower spending over time. Inflation in the costs of goods, services, and labor generally result in a higher net cost to taxpayers once a deferred capital project is eventually executed. Deferring a significant capital cost does not lower the impact to the tax rate if that project is eventually executed. The only way to mitigate the property tax impact of a major capital project is to either: a) cancel it entirely; or b) find a non-property-tax source of revenue to help pay for it. Moving it into the future creates the almost certain risk of greater property tax increases to pay for increased costs.

Risk of Affordability to Taxpayers: Although there is no consensus on specifically what the term "affordability" means for Orleans taxpayers, there does appear to be a general consensus among participants in the discussion on the CIP that bringing the costs of the CIP forward would make the tax rate unaffordable to many Orleans taxpayers. There is a significant risk that, if the Town executes the CIP in a five-year time frame, and at the same time does not find new, non-property-tax sources of revenue, the property tax rate would increase significantly and could indeed become unaffordable for many taxpayers.

One suggestion to manage this risk is to space the spending recommended in the CIP over a longer period of time. The Committee recognizes that this alternative might be able to lower the risk of increased spending on the property tax rate in any one year. However, it does nothing to mitigate the risk of overall increased costs to taxpayers and, as noted elsewhere in this letter, risks significant overall increases in total property taxes.

The Committee would also like to note that the risk of increased property taxes is unlikely to be made up for by investment gains for anyone who, at the margin, will be materially affected by such increased taxes. Statistics indicate that individuals and families living on retirement savings withdrawals and fixed incomes such as Social Security and pensions do not have sufficient value in their investments and savings to offset significant increases in property tax rates.[1]

Risk of Increased Financing Cost: The United States economy remains for the moment in a historically low interest rate environment. The Town can currently finance its capital projects for up to five years through Bond Anticipation Notes ("BANs") at an interest rate of approximately 0.4%. Municipal bonds issued by a AAA borrower such as the Town currently carry an annual interest rate of approximately 2.75%, well below historic rates. There is no certainty that these low rates will be maintained. Any material increase in interest rates will have a negative impact on the cost of borrowing to finance capital projects, which will lead to higher taxes for Town property owners.

Risk of Losing Other Wastewater Revenue Sources: Federal and state government agencies currently offer a number of low-cost revenue sources to fund wastewater spending. Examples include the State Revolving Fund, the Department of Agriculture, and others. These low, or in some cases, no-cost funding sources are limited in both time and amount. Deferring wastewater capital spending means that the Town may lose its eligibility for these programs, that the programs may become oversubscribed, or that the programs themselves may expire or run out of funds. Should the Town defer wastewater spending to the point where any of these funding opportunities are unavailable, and then decide to undertake that spending, the outcome would materially increase the cost to Orleans taxpayers.

A further risk of lost revenue of long-term deferral of wastewater spending is the loss of septage revenue. The current wastewater capital plan includes the construction of a septage treatment facility, which is projected to generate significant revenues to offset system operating costs. If this treatment facility is delayed too long, there is a risk that the Cape Cod septage market will permanently change and make the construction of such a facility unviable. This would increase the wastewater system's operating costs, which increased costs would be passed on to Orleans residents.

Risk of Workplace Health and Safety Deficiencies: The Town is aware of a significant number of health and safety violations at a number of Town facilities, including Department of Public Works ("DPW") garages, maintenance facilities, storage spaces, and other buildings and facilities. Despite being aware of these deficiencies, many of which have been publicly recognized by relevant county or state bodies, the Town has not generally taken affirmative steps to remediate or cure these deficiencies. If there is an accident or incident in which a person or private property is injured, and such incident can be attributed to one or more of these deficiencies, the Town could be found liable for any damages suffered as a result.

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[1] The average saver over 60 years of age has approximately $172,000 in savings: http://www.fool.com/investing/general/2015/10/03/the-average-americans-retirement-savings-by-ageand.aspx.

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Risk of Denial of Services: Many Town assets and personnel that provide critical services to the Town are, when not in active service, located in facilities inadequate for their minimum maintenance needs, and the Town is aware of these deficiencies. Should the Town be unable to render a critical service that results in an injury, death, or property damage, the Town may be held liable for any damages suffered as a result.

Risk of Facilities Failure: The Town owns and operates a number of facilities used by the public. Many of these facilities are deteriorating and in need of investment to maintain their physical plant. Should the Town continue to defer investment in these capital needs, there is a risk of significantly greater cost in the near- to medium-term if there is a critical failure in any of these facilities that would cost significantly more to fix on an emergency basis than if preventive investment been prudently maintained.

Risk of Beach Erosion: Nauset and Skaket beaches are significant revenue sources for the Town. Scientific studies indicate that there is an erosion problem at Nauset Beach that will cause it to shrink in the coming years. The Selectmen have chosen to defer investment in the proposed Nauset Beach retreat program over approximately 10 years. If erosion at Nauset Beach exceeds the projected rate, there is the risk of losing significant amounts of revenue from Nauset Beach, not only for beach parking, but, perhaps more significantly, from the related impact on businesses throughout the Town that depend on tourism that the Town presently enjoys. Deferment also carries the risk of incurring greater than anticipated investment costs for critical needs. The realization of this risk would be significant as it represents both lost revenue and increased costs, both of which would have to be borne by property tax payers.

Risk of Deferred Water Quality Investment: Orleans' waterways and water access are generally recognized as the Town's most valuable assets and one of the primary reasons that the Town has so many visitors and non-resident taxpayers. The Town has recognized that water quality has been deteriorating over many years, in some cases making some of our waterways unusable, impaired, or materially less attractive for residents and visitors. If the Town does not address its water quality issues, there is a risk that many of our water bodies will become less attractive for residents and visitors (including commercial fishermen), and generate less direct and indirect revenue than they currently do, with any revenue decrease borne by property tax payers.

Risk of Foregone Revenue: The Town relies heavily on residential taxpayers for revenue: in FY2016, approximately 92% of Town revenues came from residential property taxes. The Town has not, as a rule, sought revenue from non-property-tax sources other than the beaches and passive revenue collection from such items as excise, meals, and hotel taxes, despite the potential for significant non-tax revenue sources. There is material financial risk to taxpayers that, if the Town does not pursue additional, non-property-tax revenue sources, residential taxpayers will continue to bear an inequitable portion of town expenses.

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Conclusions

The Town of Orleans faces significant financial risks in the coming years. The Finance Committee is charged with advising the Town on matters of significant financial impact. Based on our analysis of the risks outlined in this memorandum, the Committee sees five alternatives for managing the cost of increased capital spending to taxpayers, some of which might be used in combination:

- Bring the costs of the Capital Improvement Plan forward, taking the pain of a significant increase in taxes sooner rather than later, but keeping the overall cost of the CIP lower than if the spending is delayed.
- Delay the CIP over a period of years, potentially lowering the cost of property tax increases in any one year, but recognizing that this will increase the overall costs of CIP implementation over time.
- Cancel one or more projects in the CIP permanently.
- Seek non-property-tax sources of revenue to offset the cost of CIP implementation to taxpayers.
- Establish methods for tax-abatement and tax-deferral for those resident taxpayers where "affordability" can be systemically and fairly demonstrated.

In addition, the Committee recommends that the Town begin to manage its revenue-producing departments (with the exception of Fire and Rescue) on a cost basis, and that all departments that collect fees for their services determine and set their fees to cover 100% of their costs.

Finally, the Committee would recommend that the Board of Selectmen make a firm commitment that, regardless of what choice they make with regard to the Capital Improvement Plan and the property tax consequences of that choice, they commit to making further policy choices that will, under all circumstances, make those spending choices "affordable". The Committee recommends that the Selectmen not limit themselves to using the property tax rate either as the sole source of revenue to fund the CIP, or as a simple justification for not making the critical infrastructure investments that the Town needs to continue to be a vibrant and sustainable community.

To thatend, the Committee recommends that the Town pursue any and all policies to ensure the CIP's affordability, which policies may include (but not be limited to) some of the following:

- Adopting a fee structure for the beaches as recommended in the Committee's March 23rd, 2016 letter to the Board of Selectmen.
- Seeking grants from the Commonwealth of Massachusetts for beach stabilization.
- Setting fees for Town services to cover 100% of the costs of the delivery of such services.
- Supporting the work of the Revenue Committee and committing to implementing its recommendations to the extent they are consistent with supporting the Town's financial goals.

- Reviewing and considering the work of the Renewable Energy Committee and supporting its recommendations to the extent that they are consistent with supporting the Towns financial goals.
- Working with private entities and investors to bring appropriate capital investment projects to the Town.
- Supporting financing structures for wastewater spending such as forty-year financing, equitable betterment charges and user fees, implementation of Property Assessed Wastewater Obligations, and other alternative sources and structures to ensure the affordability of CWRMP implementation.
- Identifying other sources of funding and financing not currently contemplated by the Town, including sources that may require changes in local or state legislation.
- Establishing meaningful tax abatement and tax-deferral policies that will ensure that necessary capital expenditures can proceed while permitting lower-income residents the ability to remain in Orleans.

Respectfully submitted,

The Orleans Finance Committee

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Joe Cardito, Vice Chair
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